

Nine points to consider before dealing with commercial space vacated before the term is up

# Leasing subleases

The concept of subleasing commercial space is not new. Sublease space becomes available when a commercial, retail, office or industrial tenant decides to unload part or all of the space he/she currently leases or occupies. This can be the result of downsizing, economic downturn, lack of business or consolidation of a company's locations and employees.

Right now in Calgary and Vancouver, for example, there is an incredible amount of sublease space on the market, representing about three million square feet of vacant space in total. This will result in a buyer's or tenant's market. However, subleasing activity is very cyclical. When occupancy rates are high there is very little subleasing activity. As vacancy rates increase, so do subleasing opportunities.

Here are nine points worth considering whether you are trying to acquire space for sublease or if you are trying to get rid of space that you no longer need:

• **Rental rate** – Sublease space normally rents for much less than landlord-leased space – often 20 per cent to 40 per cent below the market rent for that property. The original tenant must be prepared to discount the space or hold onto it. The subtenant should negotiate for and expect a bargain.

• **Term** – The subtenant is essentially taking whatever term is left on the lease. It could be 10 months or three years; it always varies from lease to lease. Obviously, the original tenant wants to sublease out the space for the balance of the term. But the subtenant must consider what will happen when the sublease expires. Will the landlord allow him/her to stay and

enter into a new lease, and at what cost? The less time left on a sublease term the more important it is for the subtenant to talk with the landlord and negotiate now to determine if there will be another lease deal in his/her future at that same location.

• **Inducements** – When the original tenant is putting his/her space on the market for sublease, he/she is competing with landlords who will be offering a tenant allowance and even free rent. This applies to space in the same building as well as other properties. This means that either the sublease rental rate needs to be low enough to offset the value of those inducements or the original tenant may need to be competitive with his/her own inducements.

• **Partial sublease** – What if only part of the space is available for sublease? The original tenant may want to give up only half of the 8,000 square feet he/she occupies. This is not uncommon but may require a new demising (or separating) wall to be created. A new entrance, or heating, ventilation and air conditioning (HVAC) separation and signage may also be required. Not only will there be a cost associated with these situations, but landlord consent will be required for any construction etc. The key here is to get the landlord's blessing on whatever renovations you do because the lease calls for it. The lease agreement may also require the original tenant to demolish the

premises back to a shell state at the end of the lease term. Be careful and read the lease's fine print.

• **Lease assignment** – One alternative to a sublease is a lease assignment. Here, the new tenant agrees to take over all of the obligations of the original tenant. This requires a lease-assignment agreement from the landlord. If a lease assignment is done, the new tenant (the assignee) then pays his/her rent directly to the landlord each month. However, on a sublease agreement, the sub-

tenant pays his/her rent to the original tenant, who then usually tops it up and pays the full rent to the landlord. Many years ago when I wanted to move the Lease Coach's Edmonton office to a downtown highrise, I found a location that an engineering office wanted to give up. Instead of subleasing, we took an assignment and stayed well beyond the two years that remained on the term at a considerable cost savings.

• **Surrender of the premises** – Instead of the original tenant subleasing his/her space out or assigning the lease agreement to another tenant, it is very possible to approach the landlord with a surrender of lease proposal. This is where the original tenant surrenders, or gives back, the space to the landlord because there is a replacement tenant ready, willing and able to enter into a new head lease. This can be a win-win-win scenario for everyone involved.

• **Real estate commissions** – Often the original tenant will give a listing to a real estate agent to find him/her a sublease tenant replacement. This may be the only way the original tenant can unload the space but it will also mean that commissions must be paid. The subtenant is negotiating to get a good deal but the original tenant may feel he/she is already thousands of dollars in the red before the sublease agreement even gets signed. Ultimately, it's a cost of doing business. Alternatively, the original tenant can run "For Sublease" ads in the newspaper since often the landlord will not allow the placement

of sublease signage on the property.

• **The lease document** – Some lease agreements require landlord consent to a sublease agreement, but others do not. The landlord may or may not have a standard sublease agreement he/she wants you to use. There are several scenarios that could play out here and I strongly recommend involving the landlord to avoid problems and misunderstanding. Make sure you have your lease documents reviewed by a professional before jumping in.

• **Default** – A sublease tenant or an assignee can fail or default on rent payments. You must make sure you know your rights and obligations before proceeding. Don't hesitate to call or e-mail the Lease Coach for some advice. It's better to be safe than sorry. ♦

*Dale Willerton is the Lease Coach, a certified commercial lease consultant who works exclusively with tenants. Willerton is author of Negotiate Your Retail, Commercial or Office Lease or Renewal. DaleWillerton@TheLeaseCoach.com 1-800-738-9202, www.TheLeaseCoach.com.*



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## How much sublease space available?

In Calgary, there is now an estimated 2.1 million square feet of sublease office space on the market, and it represents a higher proportion of vacancies than head lease space for the first time in more than 10 years, according to a survey by Avison Young. Sublease space accounts for 4.4 per cent of all the vacant office space in Calgary's central business district, while the head-lease vacancy is 3.4 per cent.

In Vancouver, vacant sublease space as of the end of the second quarter of this year totalled more than 948,000 square feet, triple the level of a year earlier. Half of the sublease space – about 460,000 square feet – is in the downtown core. Most of the vacant sublease space is smaller offices, indicating that "the downturn has affected industries across the board," according to Avison Young.

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